

**STATE OF UTAH INSURANCE DEPARTMENT
FINANCIAL EXAMINATION REPORT**

OF

PROFESSIONAL INSURANCE EXCHANGE

OF

SALT LAKE CITY, UTAH

AS OF

DECEMBER 31, 2003



September 27, 2004

Honorable Merwin U. Stewart, Commissioner
Utah Insurance Department
State Office Building, Room 3110
Salt Lake City, Utah 84114

In accordance with your instructions and in compliance with Utah Code Annotated (U.C.A.) Title 31A, an examination was conducted as of December 31, 2003, of the financial condition and business affairs of

PROFESSIONAL INSURANCE EXCHANGE

of
Salt Lake City, Utah

a mutual property and casualty insurance company, hereinafter referred to as the Company.

SCOPE OF EXAMINATION

Period Covered by Examination

The last examination was made as of December 31, 2000. The current examination covers the period from January 1, 2001, through December 31, 2003, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

Examination Procedure Employed

The examination was conducted to determine compliance with accounting practices and procedures in conformity with the applicable laws of the state of Utah, insurance rules promulgated by the state of Utah Insurance Department (Department), and Statements of Statutory Accounting Principles (SSAPs) contained within the Accounting Practices and Procedures Manual promulgated by the National Association of Insurance Commissioners (NAIC).

The examination included a general review and analysis of the Company's operations, the manner in which its business was conducted during the examination period and a determination of its financial condition as of December 31, 2003. Assets were verified and valued, and liabilities were determined or estimated.

The Company retained the services of a certified public accounting firm to audit its financial records for the years under examination. The firm allowed the examiner access and provided copies of requested working papers prepared in connection with its audits. The use of the firm's working papers did not significantly affect the nature and extent of examination procedures performed.

The examiner relied on the findings of an actuarial firm contracted by the Department to establish loss and loss adjustment expense liabilities. The examiner was responsible for testing the completeness of the records provided to the firm and the accuracy of the underlying data used to establish account values.

A letter of representation, certifying that management has disclosed all significant matters and records, was obtained from management and has been included in the examination working papers.

Status of Adverse Findings, Material Changes in the Financial Statement, and Other Significant Regulatory Information Disclosed in the Previous Examination

The Company has addressed important points and recommendations noted in the prior examination report.

HISTORY

General

The Company was organized as a reciprocal inter-insurance exchange and granted its original certificate of authority on September 1, 1978, pursuant to Utah Code Annotated (U.C.A.) §31-10. This code section was subsequently repealed and effective July 1, 1986, the Company was brought under the provisions of U.C.A. Title 31A, Chapter 5, "Domestic Stock and Mutual Insurers" as a not for profit mutual insurer. The Company is governed by the "Rules and Regulations of the Professional Insurance Exchange".

There were no amendments to the rules and regulations during the years under examination.

Management

The Company is a mutual insurer controlled by its membership. The business matters of the Company are governed by its rules and regulations. The governing body of the Company is known as the "Advisory Committee" and was composed of the following nine committee members as of December 31, 2003:

<u>Name/Residence</u>	<u>Principal Occupation</u>
Stephen M. Burton, DMD Salt Lake City, Utah	General Dentist
Scott H. Brown, DDS Cedar City, Utah	General Dentist
Mark V. Cowley, DDS Ogden, Utah	General Dentist
Richard C. Engar, DDS Salt Lake City, Utah	Attorney-in-Fact Professional Insurance Exchange
Clyde B. Olson, DDS Ogden, Utah	General Dentist
Chris R. Simonsen, DDS Bountiful, Utah	Pediatric Dentist
Gary B. Wiest, DMD Orem, Utah	General Dentist
James R. Olsen, DDS Salt Lake City, Utah	General Dentist
Brian F. Thornley, DDS Logan, Utah	General Dentist

Senior Officers serving the Company as of December 31, 2003, were:

<u>Officer</u>	<u>Title</u>
Stephen M. Burton, DMD	President
Richard C. Engar, DDS	Treasurer
Chris R. Simonsen, DDS	Secretary

Board committee members as of December 31, 2003, were:

<u>Audit Committee</u>	<u>Investment Committee</u>
Stephen M. Burton, DMD	Stephen M. Burton, DMD
Mark V. Cowley, DDS	James R. Olsen, DDS
Clyde B. Olson, DDS	Richard C. Engar, DDS

Conflict of Interest Procedure

During the period covered by the examination, committee members or officers of the Company completed conflict of interest statements annually.

Corporate Records

For examination purposes, the minutes of the meetings of the advisory, investment and audit committees were reviewed. The minutes of the meetings of the members were also reviewed.

The minutes contained detail information about the Company including current events, officer and committee member elections, investment transactions and regulatory issues. The minutes adequately approved and supported Company transactions and events. The prior examination report as of December 31, 2000, was distributed to the advisory committee on June 26, 2002.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

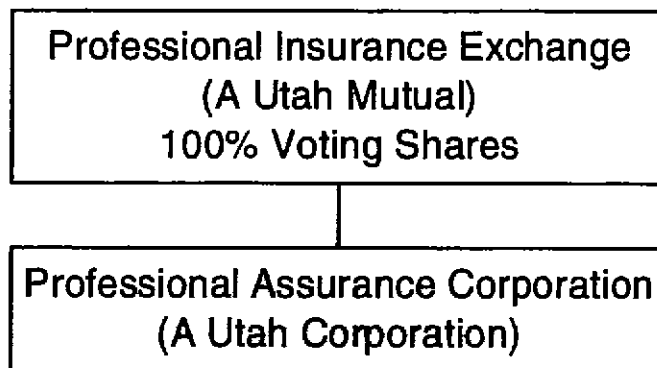
There were no acquisitions, mergers, disposals, dissolutions and purchases or sales through reinsurance that involved the Company during the examination period.

Surplus Debentures

During the period covered by the examination, the Company was not party to any surplus debentures.

AFFILIATED COMPANIES

The Company is a member of the insurance holding company system shown in the following organization chart as of December 31, 2003:



Insurance holding company registrations statements as of December 31, 2003, were filed with the Department in 2004, pursuant to U.C.A. §31A-16-105.

Cost-sharing agreements and significant regulatory information concerning parent, subsidiaries, and affiliates

In October 1998, the Company executed a management agreement with Professional Assurance Corporation (PAC), its affiliate company. The agreement states that the Company and/or its officers will, on behalf of PAC pay for accounting costs related to financial statements and audits, and maintain agency licenses and file forms and reports with the Department. The Company will receive, on a monthly basis, management fees from PAC. These management fees generally match commissions collected by PAC during the preceding period. The Company received \$45,800 in management fees in 2003, an amount that is generally consistent with prior years.

FIDELITY BOND AND OTHER INSURANCE

The Company had fidelity bond coverage over all its employees with a single loss limit of \$10,000 and a \$250 deductible, which is not within the National Association of Insurance Commissioners (NAIC) suggested minimum amount of coverage of \$75,000.

The Company had additional insurance protection including; trustee errors and omissions and general business owner's liability and property coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As a mutual insurer, with no issued and outstanding stock, the Company does not have a stock ownership program. The Company's insurance programs provided to its qualified employees and their dependents consisted of medical and dental benefits. The Company's eligible employees also participated in a profit sharing plan.

No provision for any of these plans was necessary in the financial statement of the Company.

STATUTORY DEPOSITS

Pursuant to U.C.A. §31A-4-105, the Company was required to maintain a statutory deposit in an amount equal to its minimum permanent surplus of \$700,000. The Company's minimum permanent surplus requirement was specified pursuant to U.C.A. §31A-5-211(2)(d).

A Statutory deposit held through the Department for the primary benefit of all policyholders as of December 31, 2003, was as follows:

<u>State</u>	<u>Description</u>	<u>Market Value</u>
Utah	FNMA Discount Note 1.179%	\$ 694,270
Utah	FNMA Discount Note 1.179%	\$ 94,504
Totals		<u>\$ 788,774</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

As of December 31, 2003, the Company had issued occurrence and claims-made basis dental malpractice insurance. Prior to October 1, 2003, all policies were issued on an occurrence basis. Subsequent policies were issued and renewed on a claims-made basis. The coverage limits were \$1,000,000, for any one occurrence with an annual aggregate of \$3,000,000. The policy issued by the Company to its insured contained a provision that established a contingent liability on the part of the insured to a maximum of \$2,000. This same provision allowed the attorney-in-fact, with the approval of the advisory committee and the Utah Insurance Commissioner, to levy an assessment upon the insured. A levy is permissible only if the assets are insufficient to discharge the Company's liabilities and maintain its statutory deposit.

Territory and Plan of Operation

As of December 31, 2003, the Company was licensed to write professional liability risks in the state of Utah only. The Company had two producers who were licensed and appointed to transact business for the Company. One of the producers had a contract with the Company as "Attorney-in-Fact" and the other producer had a contract as "Executive Consultant." The Company bills the insured directly for premiums.

Advertising and Sales Material

The Company did not utilize any form of commercial advertising during the examination period.

Treatment of Policyholders

No complaints were received by the Utah Insurance Department during the examination period.

REINSURANCE

Assumed

During the period covered by the examination, the Company did not assume any reinsurance.

Ceded

As of December 31, 2003, the Company maintained an excess of loss reinsurance agreement with an authorized reinsurer in the state of Utah. The agreement indemnified the Company in respect to each insured under each professional liability policy written by the Company.

The Company ceded the excess of the first \$225,000, subject to a limit of liability of \$1,000,000 each claim, \$3,000,000 aggregate.

ACCOUNTS AND RECORDS

As of December 31, 2003, the Company's accounts and records, consisting of its general ledger, registers and other subsidiary records, were maintained on a combination of manual systems and electronic data processing (EDP) systems located in the Company's office and in the offices of the Company's accountants.

An examination trial balance, as of December 31, 2003, was prepared from the Company's computerized general ledger. Account balances were traced to annual statement exhibits and schedules. Individual account balances for the examination period were examined as deemed necessary.

The Company retained the services of a certified public accounting firm to audit its financial records. Work papers evidencing audits were made available for the examiner to review.

The following record keeping deficiencies were noted by the examination:

- The Company reported in Schedule D, for its investment in a single common stock security as of December 31, 2003, an incorrect CUSIP identification and an incorrect rate per share.
- The Company did not report in Schedules D and DA the interest due and accrued on bonds not in default pursuant to the NAIC annual statement instructions.
- The Company did not report in Schedule Y the management fee revenue received from PAC, its affiliate company, pursuant to the NAIC annual statement instructions.

During the examination, the actuarial firm contracted by the Department noted discrepancies and made recommendations, concurred on by the Department, in the following areas:

- Regarding the Company's reserve work papers:

The Company reported all loss adjustment expenses reserves as Defense & Cost Containment (DCC) unpaid, without allocating a portion to Adjusting & Other (AO) unpaid, causing distortion in the one-year and two year development test reported in Schedule P, Part 2 of each annual statement. The examination recommends that the Company report and allocate the DCC and AO reserves separately.

- Regarding Schedule P of the 2003 annual statement:

The prior line values for all parts of Schedule P were not completed.

Part 6H, Section 1A was not completed correctly. Given the fact that the Company's earned premiums do not develop, the same figure should be shown across each row.

Neither of these issues materially affects the ability to estimate reasonable reserves.

FINANCIAL STATEMENT

The following financial statements are included in the examination report:

Balance Sheet as of December 31, 2003

Summary of Operations year ended December 31, 2003

Capital and Surplus for the Period 2001 through 2003

The Comments on Financial Statement immediately following the financial statements are an integral part of the statements.

PROFESSIONAL INSURANCE EXCHANGE
Balance Sheet as of
December 31, 2003

ASSETS

	<u>Amount</u>	
Bonds	\$ 626,245	
Common stocks	4,375,054	(1)
Cash and short term investments	1,407,918	(2)
Investment income due and accrued	6,362	
Current federal and foreign income tax recoverable	22,037	
Total assets	<u>6,437,616</u>	

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	272,500	
Loss adjustment expenses	687,000	
Other expenses	24,507	
Taxes, licenses, and fees	4,771	
Unearned premium	415,523	
Amounts withheld or retained by company for account of others	6,315	
Total liabilities	<u>1,410,816</u>	
Unassigned funds (surplus)	<u>5,027,000</u>	
Surplus as regards policyholders	<u>5,027,000</u>	
Totals	<u>\$ 6,437,616</u>	

PROFESSIONAL INSURANCE EXCHANGE
Summary of Operations
For the year ended December 31, 2003

UNDERWRITING INCOME

Premiums earned	\$ 843,554
Deductions:	
Losses incurred	99,727
Loss expenses incurred	242,754
Other underwriting expenses incurred	334,024
Total underwriting deductions	<u>676,505</u>
Net underwriting gain or (loss)	<u>167,049</u>

INVESTMENT INCOME

Net investment income earned	179,607
Net realized capital gains or (losses)	<u>(3,761)</u>
Net investment gain or (loss)	<u>175,846</u>

OTHER INCOME

Aggregate write-ins for miscellaneous income: management fees	45,800
Total other income	<u>45,800</u>
Net income before dividends to policyholders and before federal income tax	388,695
Dividends to policyholders	<u>-</u>
Net income after dividends to policyholders but before federal income taxes	388,695
Federal income taxes incurred	<u>66,890</u>
Net income	<u>\$ 321,805</u>

PROFESSIONAL INSURANCE EXCHANGE
Capital and Surplus
for the Period 2001 through 2003

	2001	2002	2003
Surplus as regards policyholders, December 31, previous year	\$ 3,764,684	\$ 4,308,731	\$ 4,627,233
Net income or (loss)	49,512	227,575	321,805
Net unrealized capital gains or (losses)	(78,306)	195,086	95,564
Change in nonadmitted assets	2,941	(104,159)	(17,602)
Surplus adjustments:			
Transferred from capital	569,900		
Dividends to stockholders	-	-	-
Net change in surplus as regards policyholders for the year	544,047	318,502	399,767
Surplus as regards policyholders, December 31, current year	<u>\$ 4,308,731</u>	<u>\$ 4,627,233</u>	<u>\$ 5,027,000</u>

COMMENTS ON FINANCIAL STATEMENT

(1) Common stock \$4,375,054

The Company incorrectly reported a cash management fund as a money market mutual fund that was included in common stock. To be consistent with SSAP No. 2, this cash management account was recognized as cash equivalent and reclassified from common stock to cash. The common stock asset was decreased by \$217,066.

(2) Cash and short term investments \$1,407,918

Concurrent with comment (1) the cash asset was increased by \$217,066.

CAPITAL AND SURPLUS

The Company's capital and surplus was determined to be unchanged from that reported in the Company's annual statement as of December 31, 2003. The following schedule identifies the examination changes:

<u>Description</u>	<u>Annual Statement</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
Common stock	\$ 4,592,120	\$ 4,375,054	\$ (217,066)	(1)
Cash and short term investments	1,190,852	1,407,918	217,066	(2)
Total changes			0	
Surplus as regards policyholders per Company			5,027,000	
Surplus as regards policyholders per Examination			<u>\$ 5,027,000</u>	

Pursuant to U.C.A. §31A-5-211(2)(d), the Company is required to maintain minimum capital in the amount of \$700,000. The Company reported total adjusted capital of \$5,027,000 and an authorized control level risk-based capital (RBC) requirement of \$699,748 as of December 31, 2003.

The examination determined total adjusted capital to be \$5,027,000 as of December 31, 2003. The examination accepted the Company's authorized control level RBC of \$699,748 because adjustments made for examination purposes would not have a significant effect on the RBC requirement.

SUMMARY

Items of significance or special interest contained in this report are summarized below:

Annual statement reporting deficiencies during the examination were noted.
(ACCOUNTS AND RECORDS)

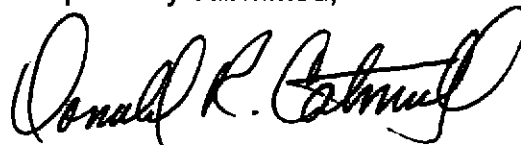
The Company had fidelity bond coverage, which is not within the NAIC suggested minimum amount. (FIDELITY BOND AND OTHER INSURANCE)

Pursuant to U.C.A. §31A-5-211(2)(d), the Company is required to maintain minimum capital in the amount of \$700,000. The Company reported total adjusted capital of \$5,027,000 and an authorized control level risk-based capital (RBC) requirement of \$699,748 as of December 31, 2003. The examination determined total adjusted capital to be \$5,027,000 as of December 31, 2003. (CAPITAL AND SURPLUS)

CONCLUSION

The assistance and cooperation extended during the course of the examination by officers, employees and representatives of the Company are acknowledged.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Donald R. Catmull". The signature is fluid and cursive, with the first and last names being more prominent.

Donald R. Catmull, AFE
Examiner in Charge, representing the
Utah Insurance Department